

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO**

In re:

The Financial Oversight and Management Board for
Puerto Rico,

as representative of

The Puerto Rico Electric Power Authority, *et al.*

Debtor.

PROMESA

Title III

No. 17 BK 04780-LTS

**DECLARATION OF STEPHEN SPENCER IN SUPPORT OF AD HOC GROUP OF
PREPA BONDHOLDERS' MOTION FOR RELIEF FROM THE AUTOMATIC STAY**

I, Stephen Spencer, hereby declare as follows under penalty of perjury pursuant to 28 U.S.C. § 1746:

1. I am a Managing Director in the Financial Restructuring Group at Houlihan Lokey ("**Houlihan**"). I lead the Houlihan Municipal Restructuring Team and have worked in the field of financial and corporate restructuring for approximately 25 years. I have particular expertise in executing out-of-court restructuring transactions involving consensual impairment of one or more creditor constituencies. I also have expertise with municipal distress and chapter 9 insolvency issues, including the cities of Detroit and San Bernardino and the Indiana Toll Road. I have researched and consulted with various states and municipalities throughout the United States, and I authored a comprehensive chapter 9 case study entitled "Restructuring the Troubled Municipality."

2. Houlihan has served since 2014 as financial advisor to an ad hoc group of holders (the "**Ad Hoc Group**") of bonds issued by the Puerto Rico Electric Power Authority ("**PREPA**" or the "**Authority**", and such Bonds, the "**Bonds**"). The Ad Hoc Group's members hold over \$3 billion in uninsured Bonds – over 37% of the approximately \$8.3 billion in PREPA's outstanding

Bond debt. I submit this Declaration (the “**Declaration**”) in support of the Movants’ Motion for Relief from the Automatic Stay (the “**Motion**”), filed contemporaneously herewith.¹ In particular, this declaration describes the history of the Movants’ efforts to negotiate a restructuring of PREPA’s debts, which took place over the last several years and in which I was intimately involved. The facts set forth in this Declaration are based on personal knowledge derived from my involvement in Houlihan’s representation of the members of the Ad Hoc Group, as well as from the Exhibits annexed hereto and the other documents that are referenced.

The Forbearance Agreement and the Restructuring Support Agreement

3. For almost three decades – from 1989 through 2015 – PREPA failed to raise its base rate (i.e., the rate charged to customers for electricity that covers all costs other than pass-through costs, like fuel expenses). However, for years, PREPA’s base rate has been inadequate to cover its debt service and many other costs.²

4. In the summer of 2014, PREPA faced a liquidity crisis, and PREPA and its creditors started urgent negotiations that culminated in a group of forbearance agreements between PREPA, the Government Development Bank (“**GDB**”) (PREPA’s fiscal advisor), and its major financial creditors, including certain members of the Ad Hoc Group, insurers of Bonds, and certain fuel line of credit lenders. The agreement between PREPA, the Ad Hoc Group, and the insurers of Bonds (the “**Forbearance Agreement**”) is annexed as Exhibit A.³ Under the

¹ The Movants are the members of the Ad Hoc Group, Assured Guaranty Corp., Assured Guaranty Municipal Corp., National Public Finance Guarantee Corp., and Syncora Guarantee Inc.

² Donahue October 2016 testimony, attached to the HasBrouck Declaration as Exhibit E, (hereinafter “**Donahue October 2016 Testimony**”) at 21.

³ The version of the Forbearance Agreement in Exhibit A is the original Forbearance Agreement that the parties entered into on August 14, 2014. The Forbearance Agreement was amended a number of times. Those amendments – as well as the other forbearance agreements PREPA entered into at the time and the amendments to those agreements – are available at the Government Development Bank’s website, http://www.gdb-pur.com/investors_resources/prepa.html.

Forbearance Agreement, bondholders made various agreements, including to forbear from exercising certain remedies against PREPA and to amend the Trust Agreement to, among other things, temporarily suspend PREPA's requirement to refill money set aside in bondholder reserves to pay the bondholders. *Id.* (A copy of the Trust Agreement before that amendment went into effect is annexed as Exhibit B.⁴)

5. As part of its responsibilities under the Forbearance Agreement, PREPA agreed to appoint a Chief Restructuring Officer ("CRO") who would work to renegotiate PREPA's debt, address PREPA's operational problems, and try to restore PREPA's financial health. *See* Exh. A at § 5(h)(x), Annex E; *see also* Energy Commission Order (HasBrouck Decl., Exh. A) at 14. On September 11, 2014, PREPA hired Lisa Donahue of AlixPartners as PREPA's CRO and retained AlixPartners as PREPA's outside restructuring consultant.⁵

6. The parties to the Forbearance Agreement also began intensive negotiating that, months later, resulted in a holistic, consensual restructuring of PREPA's debt, memorialized in a restructuring support agreement in late 2015 entered into by and among PREPA, the Movants, and certain other creditors of PREPA (as amended and restated in March 2016 and as supplemented from that date, the "RSA"). Dkt. No. 2, at 8-9.⁶

⁴ There have been additional amendments to the Trust Agreement since that date. The Sixteenth Supplemental Agreement to the Trust Agreement is attached as Annex C to the Forbearance Agreement (Spencer Decl., Exh. A). The Seventeenth Supplemental Agreement to the Trust Agreement can be found at: <https://emma.msrb.org/EA974961.pdf>. The Eighteenth Supplemental Agreement to the Trust Agreement can be found at: <https://emma.msrb.org/ES1003663.pdf>. The First Amendment to the Eighteenth Supplemental Agreement to the Trust Agreement can found at: <https://emma.msrb.org/ER1168761.pdf>. The Nineteenth Supplemental Agreement to the Trust Agreement can be found at: <https://emma.msrb.org/ER1230760.pdf>.

⁵ *PREPA Appoints Lisa J. Donahue as Chief Restructuring Officer to Expedite Financial and Operational Improvements*, PR Newswire (Sept. 4, 2014), <http://www.prnewswire.com/news-releases/prepaappoints-lisa-j-donahue-as-chief-restructuring-officer-to-expedite-financial-and-operational-improvements-274019911.html>.

⁶ All references to Dkt. are to the docket of the PREPA Title III proceeding, Case No. 17-4780.

7. Despite statutory and contractual protections designed to ensure payment in full through adequate rates, Movants agreed to voluntary concessions designed to allow PREPA to invest in the System (as defined in the Trust Agreement) in order to create a modern, cost-efficient utility. These concessions included the voluntary exchange of uninsured Bonds at a discount into securitization bonds issued by a newly created public corporation (the “**SPV**”) secured by the SPV’s right to assess a charge on electrical use (a “**Transition Charge**”) and providing that the new securitization bonds would pay only interest for the first five years after issuance. These concessions were described in testimony that Ms. Donahue provided to the U.S. Senate, a copy of which is attached to the HasBrouck Declaration as Exhibit G.

8. It was contemplated that the RSA would be consummated through a tender offer asking PREPA’s uninsured bondholders to exchange their Bonds for new securitization bonds issued by the SPV. To facilitate the implementation under the RSA, certain insurers agreed to provide first loss protection on the SPV bonds through the issuance of approximately \$435.6 million of surety bonds that would fund the debt service reserve fund for the new SPV bonds.

9. As part of the RSA, certain creditors also agreed to help PREPA with its liquidity position and avoid a default on its Bonds. Certain of the Movants agreed to fund the scheduled debt service through the purchase of newly issued Bonds – essentially deferring payments owed to them (or on Bonds insured by them) to avoid a payment default. This dramatically reduced the amount of money that PREPA was required to pay to bondholders over the past three years. In total, the supporting creditors allowed PREPA to defer \$374 million in debt service payments. Dkt. No. 2, at 4.

Changes and Termination of the RSA by Governor Rosselló’s Administration

10. After Governor Rosselló took office, PREPA's creditors were informed via a press release from AAFAF (the Puerto Rico Fiscal Agency and Financial Advisory Authority, "AAFAF") that AAFAF "is the only entity of the government of Puerto Rico authorized to negotiate and reach agreement with creditors Therefore, AAFAF . . . informed [PREPA] that AAFAF and its financial advisor, Rothschild, will now lead the negotiations with PREPA creditors." A copy of that press release is annexed as Exhibit C. PREPA's creditors then agreed to additional concessions in order to improve PREPA's financial position over the next ten years (the "RSA Enhancements"). The RSA Enhancements were agreed to in principle on April 6, 2017, and formally incorporated into the RSA on April 27, 2017.⁷ The RSA Enhancements reflected PREPA's new ability under Title VI of PROMESA potentially to force uninsured bondholders to accept the RSA, thus eliminating the cost of Holdout Bonds.⁸

11. Certain creditors, including Movants, also agreed to another relending transaction (the "2017 Relending"), a purchase of \$280 million of newly issued Bonds which would reduce the amount of money that PREPA would need to pay to bondholders on July 3, 2017 from \$450 million to \$170 million. *See* Annex K to RSA, a copy of which is annexed hereto as Exhibit D. PREPA indicated that, absent the 2017 Relending, it would not have sufficient liquidity to pay the full amount of debt service on the Bonds that was due and payable on July 3, 2017. *See* PREPA Public Disclosure Dated March 21, 2017, EMMA at 9, a copy of which is annexed as Exhibit E.

⁷ *See*, Public Disclosure Dated April 6, 2017, Electronic Municipal Market Access, Municipal Securities Rulemaking Board, <https://emma.msrb.org/ER1046043-ER819555-ER1220619.pdf> (hereinafter "PREPA Apr. 6 EMMA Filing"); *see also* Public Disclosure Dated April 28, 2017, Electronic Municipal Market Access, Municipal Securities Rulemaking Board, <https://emma.msrb.org/ER1046043-ER819555-ER1220619.pdf>.

⁸ *See* PREPA Apr. 6 EMMA Filing at 24 (stating that treatment of "Non-RSA Bondholders" will be "implementation through Title VI" of PROMESA).

12. Governor Rosselló trumpeted these concessions and the benefits of the RSA as a consensual deal with creditors, saying that the negotiated terms “will set PREPA on a path toward becoming a modern utility that will provide reliable power at sustainable rates to the people of Puerto Rico.” (AAFAF April 6 Press Release, annexed as Exhibit F; *see also* May 1 Press Release, at 2, annexed as Exhibit G.) In late April 2017, PREPA sent a letter to the Oversight Board established under PROMESA asking for authority under Title VI of PROMESA to implement the transactions in the RSA.⁹

13. However, the Oversight Board failed to act on that request for two months. Similarly, Governor Rosselló’s administration started to back away from the RSA. For example, it refused the Ad Hoc Group’s requests for meetings and refused to meet basic components of the RSA (such as providing real explanations, and sources and uses, to justify demands for further loans). While the administration avoided taking steps necessary to consummate the RSA, upon information and belief, it continued to publicly cite to the RSA as evidence of Puerto Rico’s willingness to negotiate with creditors.

14. Finally, on June 28, 2017 the Oversight Board refused to certify the RSA for implementation.¹⁰ That same week, the creditors offered to extend certain deadlines in the RSA to allow time for continued discussions, but PREPA refused to consent to those extensions. Instead, it determined that it would reject the 2017 Relending and let the RSA terminate on June 29, 2017.

⁹ See Letter from Oversight Board to Mohammad Yassim, Chief Legal & Regulatory Officer, AAFAF (June 28, 2017) at 1, <https://juntasupervision.pr.gov/wp-content/uploads/wpfd/50/59558f7c56536.pdf> (hereinafter “Oversight Board Letter”).

¹⁰ *Id.*

15. Simultaneously, the Governor dismissed the prior PREPA board and named three new board members.¹¹ Of the three new board members, Mr. Marrero is already a member of the Rosselló administration, Mr. Irizarry is an environmental engineer and attorney, and Mr. Sgroi is a real estate agent who served as treasurer in Governor Rosselló's gubernatorial campaign.¹²

I declare under penalty of perjury pursuant to 28 U.S.C. § 1746 that, to the best of my knowledge, information and belief, the foregoing is true and correct.

Executed in New York, NY, on July 18, 2017

/s Stephen Spencer

Stephen Spencer
Managing Director
Houlihan Lokey

¹¹ Press Release, a certified English translation of which is annexed as Exhibit H-1. The original Spanish language press release is annexed as Exhibit H-2.

¹² Exhibit H; *see also* Cindy Burgos Alvarado, *Governor Appoints Three New Puerto Rico Power Authority Board Members*, June 28, 2017, Caribbean Business, <http://caribbeanbusiness.com/governor-appoints-three-puerto-rico-power-authority-board-members/>. The Governor also nominated a new Executive Director for PREPA on March 3, 2017. Ramos Press Release, a certified English translation of which is annexed here as Exhibit I-1. The original Spanish language press release is annexed as Exhibit I-2.